ALABAMA DEPARTMENT OF REVENUE
ADMINISTRATIVE CODE

CHAPTER 810-3-15

Deductions for Individuals Generally

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810-3-15-.01 General Provisions.

(1) For tax years beginning after December 31, 1997, no deduction shall be allowed for any losses, expenses, or interest deferred or disallowed pursuant to 26 U.S.C. §267. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(2) For tax years beginning after December 31, 1986, no expenses shall be allowed for any cost required to be capitalized in accordance with 26 U.S.C. §263A.

(3) An individual who is a part-year resident of Alabama may deduct expenses allowed by §40-18-15, Code of Alabama 1975, only to the extent that the expenses were paid during the period the taxpayer was a resident of Alabama. If a deduction was paid for the entire year, such as interest or taxes, and the amount actually paid while a resident cannot be determined, the taxpayer may prorate the deductible amount based on the number of months of Alabama residency.

(4) Double deductions are not permitted. Amounts deducted under one provision of this title cannot be deducted under another title.

Author: Ann F. Winborne, CPA, Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§ 40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Rule effective October 1, 1982.
Amended June 19, 1992.
Amended: Filed September 18, 1996, effective October 23, 1996.
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810-3-15-.02 Business Expenses.

(1) Business expenses deductible from gross income include the ordinary and necessary expenses paid or accrued during the taxable year, directly connected with or pertaining to the taxpayer's trade or business, as determined in accordance with 26 U.S.C. §162.

(2) The provisions and limitations of 26 U.S.C. §274 also apply to expenses for business travel, meals, and entertainment otherwise allowable under 26 U.S.C. §162.

(3) Unreimbursed employee business expenses and certain other miscellaneous itemized deductions are deductible only to the extent that the aggregate of the deductions exceeds 2-percent of adjusted gross income as defined in Code of Alabama 1975, §40-18-14.2.

(4) A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming in accordance with 26 U.S.C. §162.

(5) Alabama income tax law requires that taxpayers maintain such records as will be sufficient to enable the Department of Revenue to correctly determine tax liability. It is to the advantage of taxpayers who may be called upon to substantiate deductions to maintain as adequate and detailed records as is practical since the burden of proof is on the taxpayer to show that such deductions were not only paid or accrued but also were ordinary and necessary business expenses, as defined in 26 U.S.C. § 162.

(6) For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(7) The provisions of the federal "Taxpayer Relief Act of 1997" which were adopted by Alabama Act 98-502 have the same effective date for Alabama income tax purposes as they do for federal income tax purposes.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, Betty Knowles, and Ann F. Winborne, CPA
Authority: Sections 40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Effective December 4, 1992.
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810-3-15-.03 Interest Expense.

(1) Effective for all taxable years beginning after December 31, 1997, interest paid or accrued within the taxable year on indebtedness shall be limited to the amount allowable as an interest deduction for federal income tax purposes in the corresponding tax year or period pursuant to the provisions of 26 U.S.C. §§163, 264, and 265. Educational loan interest is not deductible for Alabama income tax purposes. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(2) Effective for all taxable years or periods beginning after December 31, 1987, and prior to December 31, 1997, interest paid or accrued within the taxable year on indebtedness shall be limited to the amount allowable as an interest deduction for federal income tax purposes in the corresponding tax year or period pursuant to the provisions of 26 U.S.C. §163.

(3) For taxable years beginning prior to January 1, 1988, all interest paid or accrued within the taxable year on indebtedness was fully deductible.

(4) The provisions of the federal "Taxpayer Relief Act of 1997" which were adopted by Alabama Act 98-502 have the same effective date for Alabama income tax purposes they do for federal income tax purposes.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended June 17, 1988.
Amended: Filed May 16, 1989, effective June 20, 1989.
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810-3-15-.04 Deductibility of Taxes.

(1) The following taxes imposed by the United States or any possession of the United States are deductible by the taxable entity upon whom the taxes are imposed:

(a) Income taxes

(b) Federal Insurance Contribution Act (FICA) taxes

(c) Self-employment taxes

(d) Estate and gift taxes

1. Estate taxes are imposed on the estate.

2. Gift taxes are imposed on the donor.

(2) State, local, and foreign occupational license taxes and contributions to state unemployment funds are deductible.

(3) The following taxes are deductible to the same extent that the taxes are deductible for federal income tax purposes under 26 U.S.C. §164, in accordance with federal regulations for 26 U.S.C. §164:

(a) State, local, and foreign real property taxes.

(b) State and local personal property taxes.

1. The term "personal property tax" means an ad valorem tax which is imposed on an annual basis in respect to personal property.

(c) The generation-skipping transfer (GST) tax imposed on income distributions by 26 U.S.C. §2601.

(4) There shall be allowed a deduction for state, local, and foreign taxes, and taxes imposed by authority of the United States or any possession of the United States, which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in 26 U.S.C. §212 (relating to expenses for production of income).

(5) Notwithstanding the preceding sentence, any tax which is paid or accrued by the taxpayer in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition. Cross references: Code of Alabama 1975, §§40-18-6, 40-18-15, 40-18-16, and 40-18-17.

(6) See also Rule 810-3-15-20, Federal Income Tax Deduction - Individuals.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
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Amended February 8,1989.
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810-3-15-.05 Depreciation, Amortization, and Section 179 Expense.

(1) Effective for all taxable years beginning after December 31, 1997, there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in a trade or business, or of property held for the production of income, in accordance with 26 U.S.C. §§167 and 168. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(2) Effective for all taxable years beginning after December 31, 1997, intangible assets which are used in a trade or business or held for the production of income may be amortized in accordance with 26 U.S.C. §197. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(3) A deduction is allowable for the amortization of start-up expenditures in accordance with 26 U.S.C. §195, but in the case of a nonresident, only if the principal place of business being investigated, created, or acquired is located in the State of Alabama.

(4) For taxable years beginning after December 31, 1989, a taxpayer may elect to treat the cost of any section 179 property as an expense which is not chargeable to a capital account in accordance with 26 U.S.C. §179.

(5) For taxable years beginning before January 1, 1998, Alabama income tax law and regulations were similar to the provisions of the Internal Revenue Code and regulations concerning depreciation and amortization of intangible assets. Applicable federal regulations and determinations pertaining to depreciation and amortization of intangible assets will be followed in administering this rule for those tax periods. See also Rule 810-3-1.1-.01, Operating Rules.

(6) The provisions of the federal "Taxpayer Relief Act of 1997" which were adopted by Alabama Act 98-502 have the same effective date for Alabama income tax purposes as they do for federal income tax purposes.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, Betty Knowles, Ewell Berry, and Ann F. Winborne, CPA
Authority: §§40-2A-7(a)(5) and 40-18-18, Code of Alabama 1975
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810-3-15-.06. Depletion.

(1) There shall be allowed as a deduction in computing taxable income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion.

(a) Depletion allowance for standing timber shall be computed solely on the adjusted basis of the property.

(b) Depletion allowance for oil and gas may be computed on either the cost depletion method or on a percentage of gross income from the property, see Reg. 810-3-16-.01.

(c) Depletion allowance for other exhaustible natural resources shall be computed on the cost depletion method.

(d) The basis for depletion shall be determined in accordance with §§40-18-16 and 40-18-6, Code of Alabama 1975.

(2) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest consists of a capital investment in timber or mineral in place together with recovery of the investment through production.

(a) The allowance for depletion should be equitably apportioned between the lessor and lessee. Each should compute cost depletion from his own adjusted basis; each should compute percentage depletion from his own income from the property. One may use percentage depletion while the other may use cost.

(3) Computation of depletion on basis of cost (mines, oil and gas properties). When the adjusted basis applicable to the mineral deposit has been determined under §40-18-16 cost depletion for the taxable year is computed by:

(a) Dividing the adjusted basis of the property by the number of recoverable units to arrive at the rate per unit.

(b) Multiply the rate per unit by the number of units sold in the taxable year if the taxpayer is on the accrual method, or the number of units for which payment is received if the taxpayer is on the cash method.

$$\text{Cost depletion} = \frac{\text{adjusted basis}}{\text{recoverable units}} \times \text{Units sold or paid for in taxable year}$$

1. In the selection of a unit of mineral for depletion, preference shall be given to the customary unit or units paid for the product sold, such as tons of ore, barrels of oil, or thousands of cubic feet of natural gas.

2. The number of recoverable units is the number of units of mineral determined by geological survey to be available for recovery.

(i) After the predetermined number of units have been recovered, no cost depletion is then allowed on any excess recovered.

3. In determining the amount of the adjusted basis of the mineral deposit there shall be excluded:

(i) amounts representing the cost or value of the land for purposes other than mineral production,

(ii) the amount recoverable through depreciation and through deductions other than depletion, and

(iii) the residual value of the property at the end of operations, but there shall be included, in the case of oil and gas wells, those amounts of capitalized drilling and development costs which are recoverable through depletion.

(4) Computation of depletion on basis of cost (timber). Only cost depletion is allowed in computing depletion of timber. The amount of depletion to be deducted during the year is the number of units of timber cut times the depletion unit. The depletion unit is the basis of the timber under §40-18-16 divided by the total depletable units (M board feet, cords, etc.). Depletion is deducted in the same year the cut timber is sold or otherwise disposed of, except that if a taxpayer elects to treat cutting as a sale, depletion is taken in the year of cutting as basis of timber cut:

$$\frac{\text{Basis}}{\text{Total depletable units}} \times \text{units cut} = \text{depletion allowable}$$

(a) A timber account should normally be set up to include all of the timber in one "block", a block being an operational unit which includes all of the taxpayer's timber which logically goes to a single given point of manufacture, or the timber which would logically be removed by a single logging development.

(b) The "total depletable units" shall be determined by a professional cruising of the timber.

(c) After the above determined number of units have been used in computing the depletion allowed, no further depletion is allowed on any excess units removed.

(5) Computation of depletion on basis of percentage of gross income (oil and gas wells). For a description of the calculation of percentage depletion, see Reg. 810-3-16-.01.

(6) Computation of depletion on basis of discovery value (mines, oil and gas properties). With respect to any property for which discovery value is the taxpayer's basis for depletion, the depletion for any taxable year shall be computed by:

(a) Determining the number of units available to be removed and the unmined value of each unit by a professional geological survey.

(b) As each unit is sold depletion is allowable at the above predetermined unmined value.

(c) When the above total predetermined units have been allowed as depletion, no further depletion is allowed on any excess units removed and/or sold.

(7) Determination of fair market value. If the fair market value of the property at a specified date is to be determined for the purpose of ascertaining the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Department, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or subsequent improvements in methods of extraction and treatment of the mineral product. The value sought should be established assuming a transfer between a willing seller and a willing buyer existed as of that particular date. The Department will give due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, market value of stock or shares, royalties or rentals, valuation for local taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in a probate court, and, in the absence of better evidence, disinterested appraisals by approved methods.

(8) Depreciation of improvements. A reasonable provision for depreciation shall be allowed with respect to tangible properties, other than land and inventory properties, which are not subject to depletion, as in the case of mines, oil and gas wells, and other natural deposits and timber. It shall be optional with the taxpayer whether the cost or other basis of the plant and equipment plus allowable capital additions and minus salvage value shall be recovered,

(a) by reasonable charges for depreciation (see Reg. 810-3-15-.05) at a rate determined by the physical or economic life of such plant or equipment, or

(b) at a rate established by the exhaustion of the wasting asset, or

(c) according to the particular conditions of the case, by a method satisfactory to the Department.

Authors: Ann F. Winborne, CPA, Jerilyn P. Christian
Authority: §40-18-15, Code of Alabama 1975
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810-3-15-.07 Losses.

(1) The following losses sustained during the taxable year and not compensated for by insurance or otherwise are deductible by individuals:

(a) Losses incurred in a trade or business, in accordance with 26 U.S.C. §165(c)(1).

(b) Losses incurred in any transaction entered into for profit, though not connected with a trade or business, in accordance with 26 U.S.C. §165(c)(2), but in the case of a non-resident, only as to those transactions within the state.

(c) Casualty and theft losses sustained during the taxable year of property not connected with the conduct of a trade or business or a transaction entered into for profit as determined in accordance with 26 U.S.C. §165(c)(3) and (h). In the case of a nonresident, the deduction shall be allowed only for the losses arising from property located within the State of Alabama and the limitations in 26 U.S.C. §165 shall be applied only with regard to the taxpayer's Alabama adjusted gross income.

(d) Losses from debts ascertained to be worthless and charged off during the taxable year of ascertainment, if sustained in the conduct of the regular trade or business of the taxpayer. The reserve method for bad debts is not allowed for individuals.

(2) For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(3) Losses from personal bad debts not incurred in a trade or business, nor in a transaction entered into for profit, are not deductible.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975.
History: Adopted October 1, 1982.
Amended July 27, 1988.
Amended May 15, 1992.
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810-3-15-.09 Nontrade or Nonbusiness Expenses.

(1) In accordance with 26 U.S.C. §212, an individual is allowed a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year:

(a) for the production or collection of income;

(b) for the management, conservation, or maintenance of property held for the production of income; or

(c) in connection with the determination, collection, or refund of any tax.

(2) The provisions and limitations of 26 U.S.C. §274 also apply to deductions for travel, entertainment, and meals.

(3) Except as otherwise provided in Alabama law, nontrade or nonbusiness expenses are not deductible.

(4) For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
Amended Filed July 27, 1988.
Amended May 15, 1992.
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810-3-15-.12 Moving Expenses.

(1) Effective for taxable years beginning January 1, 1990, a deduction is allowed for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work in accordance with 26 U.S.C. §217; provided, however, that the "new principal place of work" is located within the State of Alabama. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
Amended July 27, 1988.
Amended May 15, 1992.
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810-3-15-.13 Alimony and Separate Maintenance Payments.

(1) Effective for taxable years beginning January 1, 1990, alimony and separate maintenance payments will be deductible in accordance with 26 U.S.C. §215. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

(2) For taxable years ending after December 31, 1984, and before January 1, 1990, alimony and separate maintenance payments will be deductible as provided in 26 U.S.C. §215 as in effect on January 1, 1985.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§ 40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
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Amended May 15, 1992.
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810-3-15-.14 Deductions Allowable for Retirement Savings - IRA, SEP, and Keogh Plans.

(1) A deduction is allowed for an individual's qualified retirement contribution in accordance with 26 U.S.C. §219.

(2) A deduction is allowed for contributions of an employer to an employees' trust or annuity plan, or for compensation paid or accrued on account of an employee under a deferred-payment plan, in accordance with 26 U.S.C. §404.

(3) For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
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Amended May 15, 1992.
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810-3-15-.16 Medical and Dental Expenses. A deduction is allowed for expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent, in accordance with 26 U.S.C. §213; provided, however, that the limitation of the deduction to the excess of those expenses over 7.5 percent of adjusted gross income as provided in 26 U.S.C. §213 shall instead be limited to the excess of those expenses over 4.0 percent of adjusted gross income as defined in Code of Alabama 1975, §40-18-14.2. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
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Amended May 15, 1992.
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810-3-15-.17 Charitable Contributions. A deduction for charitable contributions is allowable to the extent allowed for federal income tax purposes under 26 U.S.C. §170; provided, however, that the contributions base shall be the adjusted gross income as defined in Code of Alabama 1975, §40-18-14.2, except for any net operating loss carryback deduction allowable by §40-18-15.2. For interpretation of federal statutes adopted by the Alabama Legislature, see Rule 810-3-1.1-.01, Operating Rules.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted October 1, 1982.
Amended July 27, 1988.
Amended May 15, 1992.
Amended September 18, 1996, effective October 23, 1996.
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810-3-15-.19 Optional Standard Deduction.

(1) A deduction is allowed for resident individual taxpayers filing Form 40 or nonresident individual taxpayers filing Form 40NR who elect to claim an optional standard deduction instead of itemizing their nonbusiness expenses for medical and dental care, taxes (other than federal income taxes), interest, contributions, casualty and theft losses, long-term health care premiums, and miscellaneous deductions allowable by Code of Alabama 1975, §40-18-15. For tax years beginning January 1, 1982, the maximum optional standard deduction:

(a) for a single taxpayer, head of family, or a married taxpayer filing a separate return, is 20% of adjusted gross income, or $2,000, whichever is less.

(b) for married taxpayers filing a joint return, is 20% of adjusted gross income or $4,000, whichever is less.

(c) for a nonresident, is the amount determined under subparagraph (1)(a) or (1)(b) above,apportioned by the percentage of Alabama adjusted total income to total income from all sources.

(2) Adjusted gross income is determined in accordance with Code of Alabama 1975, §40-18-14.2.

(3) Federal income taxes paid or accrued during the taxable year may be deducted in addition to the optional standard deduction.

(4) If a husband and wife file separate returns and one spouse itemizes deductions, the other spouse will not be allowed to claim the optional standard deduction but must also itemize deductions.

(5) For tax years beginning January 1, 1985, the election to claim the optional standard deduction is revocable. If a taxpayer claims itemized deductions which are less than the allowable optional standard deduction, an amended return may be filed claiming the optional standard deduction. If a taxpayer claims the optional standard deduction which is less than the allowable itemized deductions, an amended return may be filed claiming the itemized deductions.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975.
History: Adopted September 30, 1982.
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810-3-15-.20 Federal Income Tax Deduction - Individuals.

(1) **DEFINITIONS**. For the purpose of this regulation, the following words, phrases and abbreviations have these meanings:

(a) **FIT**: Federal income tax. Deductible federal income tax includes:

1. Federal income tax withheld by employers during the taxable year.

2. Excess social security or Medicare tax (FICA) and railroad retirement tax (RRTA) withheld during the taxable year and claimed as federal income tax on the federal return for the same year. Regular FICA and RRTA tax withheld cannot be claimed as federal income tax since these can only be claimed as itemized deductions.

3. All federal income tax payments made during the year for liabilities of prior years, including the previous year's payment made when the previous year return was filed.

4. All federal income tax estimate payments made during the year. Any overpayments of previous years which are applied to the current year's estimated tax are not deductible unless the overpayment is included in income as a refund of federal income tax.

5. Earned income credit of the previous year which was applied to the previous year's federal income tax liability.

6. Alternative Minimum Tax.

(b) Federal income tax does not include:

1. Federal accumulated earnings tax,

2. Self-employment taxes,

3. Social security and Medicare tax on tip income not reported to employers,

4. Tax on excess contributions to Individual Retirement Arrangements,

5. Tax (10% Additional Tax) on early distributions from a qualified retirement plan (including IRAs),

6. Tax on excess accumulations in qualified retirement plans (including IRAs),

7. Tax on excess distributions from qualified retirement plans (including IRAs),

8. Advance earned income credit payments,

9. Household employment taxes,

10. Penalties and interest.

(c) **FIT Paid**: Payment includes FIT withholdings, FIT paid by the taxpayer, and FIT paid through wage garnishments.

(d) **FIT Accrued**: Imposed FIT payable for the year.

(e) **Paid or Accrued**: Either paid or accrued, but not both.

(f) **Transition Year**: The year in which the method of computing the FIT deduction is changed; i.e., from cash method to accrual method or vice versa. The change in method can be the result of taxpayer's request or a Revenue Department directive.

(g) **To Contest**: To challenge via some objective act of protest, substantiated by some affirmative evidence of denial of liability by the taxpayer.

(2) **FEDERAL INCOME TAX DEDUCTION FOR RESIDENTS**. Net federal income tax may be deducted for the taxable year in which paid or accrued. Taxes are deductible only by the person or entity upon whom they are imposed. A cash basis taxpayer may allocate his federal income tax deduction on the cash basis or accrual basis. Once a method is selected, it shall be consistently applied from year to year, unless approval for a change is obtained from the Department. An accrual basis taxpayer must allocate his federal income tax deduction using the accrual basis.

(a) **FOR RESIDENTS SELECTING THE CASH BASIS**:

1. FIT is deducted in the year paid, regardless of the year for which it is imposed.

2. If the taxpayer received a prior-year tax benefit from the deduction of FIT resulting in a reduction of tax paid to Alabama in the prior year, the amount of the FIT refund must be included in income in the year received. See Reg. 810-3-14-.04.

3. EXAMPLE 1: Taxpayer has $1,200 withheld from his earnings during 19X8 for federal income taxes. In March, 19X8, he paid $100 additional tax on his 19X7 liability and $200 on his declaration of estimated tax for 19X8. He paid an additional assessment of $300 on his 19X5 income in September 19X8, thereby settling a disputed liability for 19X5. The taxpayer reports his income for state

income tax purposes using the cash receipts and disbursements method. He may deduct for the calendar year 19X8 all payments listed above, totaling $1,800.

4. EXAMPLE 2: A taxpayer made the same payments as listed in the preceding example, except that he received a $300 refund of 19X5 taxes, for which he received a tax benefit, in September, 19X8, thereby settling the disputed 19X5 liability. Taxpayer selected the cash basis to compute the federal income tax deduction. He may deduct for the calendar year 19X8 all payments listed above, totaling $1,500, and the $300 refund must be reported as income.

(b) **FOR RESIDENTS SELECTING THE ACCRUAL METHOD**:

1. Uncontested FIT is deducted in the year for which it is imposed.

2. Contested FIT is deducted in the year in which the liability becomes fixed and certain, but in no case later than the year in which the tax was actually paid.

3. Refunded FIT is reported in the year received but only if the taxpayer received a prior-year tax benefit from deduction of the FIT refunded.

4. EXAMPLE 3: A taxpayer using the accrual basis, who had made the same payments listed in Example 1 above, determined early in 19X9 that his federal income tax liability for 19X8 would be $1,700. He had previously paid $1,400 and therefore would have to pay an additional $300. He may deduct $1,700 accrued for 19X8 plus $300 accrued during 19X8 on his contested 19X5 liability, for a total of $2,000. He may not deduct $100 paid in 19X8 on his 19X7 liability, since this amount accrued in 19X7 and should have been deducted in that year.

5. EXAMPLE 4: A taxpayer using the accrual basis, who had made the same payments as those listed in Example 2 above, determined early in 19X9 that his federal income tax liability for 19X8 would be $1,700 and that he had paid $1,400 and would have to pay an additional $300. He may deduct the $1,700 accrued for 19X8. He may not deduct the $100 paid in 19X8 on his 19X7 liability, since this amount accrued in 19x7 and should have been deducted in that year. The $300 refund accrued during 19X8 on his contested 19X5 tax liability should be reported as income on his 19X8 return.

(c) **MARRIED TAXPAYERS**: For spouses who file a joint federal income tax return but separate Alabama income tax returns for the same year, the FIT deduction of each is based on the ratio of Alabama adjusted gross income of each to the total Alabama adjusted gross income of both.

1. EXAMPLE 5: Proration Based on Alabama Adjusted Gross Income

	Husband	Wife	Total
Income - Salaries, wages, etc.	$7,000	$4,000	$11,000
Income - Other	500	500	1,000
Totals	$7,500	$4,500	$12,000
Ratio of income for each spouse	62.5%	37.5%	100%
Total federal income tax			$ 2,400
Husband: $2,400 x 62.5%	$1,500		
Wife: $2,400 x 37.5%		$ 900	

The husband deducts $1,500 on his state return and the wife deducts $900 on her state return for federal income tax. Total federal income tax deducted on both state returns is $2,400, the amount to be prorated.

(3) **NONRESIDENTS**: The FIT deduction for Alabama shall be apportioned according to the ratio of adjusted gross income from Alabama sources to the total adjusted gross income from all sources (as computed under Alabama law, not federal law). Each annual FIT deduction must be computed separately. Cash basis nonresidents may compute the FIT deduction on the cash basis or may elect to compute it on the accrual basis. The election, once made, must be consistently applied from year to year unless prior written approval for a change is obtained from the Department.

(a) **FOR NONRESIDENTS SELECTING THE CASH BASIS**:

1. FIT is deducted in the year paid, regardless of the year for which it is imposed.

2. Refunded FIT is reported in the year received but only if the taxpayer received a prior-year tax benefit from deduction of the FIT refunded.

3. Copies of the federal income tax returns for all years used in the computation of the FIT deduction must be submitted with the return.

4. EXAMPLE 6: A nonresident taxpayer had adjusted gross income in 19X2 from sources within Alabama of $10,000 and adjusted gross income from sources within and without Alabama of $25,000. Data regarding his federal income tax is:

Federal income tax liability for 19X2	$5,500
Withheld in 19X2	$3,600
Paid in 19X2 on 19X2 federal estimate	$ 800
19X1 federal tax paid in 19X2 (on estimate, final return, or otherwise)	$ 300
19X0 federal tax paid in 19X2	$ 500
19X1 federal income tax refund received in 19X2	$ 400

19X1 ratio of Alabama AGI to federal AGI	60%
19X0 ratio of Alabama AGI to federal AGI	30%

(19X1 and 19X0 ratios based on 19X1 and 19X0 returns.)

For the 19X2 tax year, the ratio of adjusted gross income from sources within Alabama to adjusted gross income from sources within and without Alabama is 40% ($10,000 divided by $25,000).

Total 19X2 payment	$4,400
Deduction for 19X2 tax (40% of $4,400)	$1,760
Deduction for 19X1 tax (60% of $300)	$ 180
Deduction for 19X0 tax (30% of $500)	$ 150
Refund of 19X1 tax (60% of $400)	$ 240
Total 19X2 FIT deduction ($1,760 + $180 + $150 - $240)	$1,850

(b) **FOR NONRESIDENTS SELECTING THE ACCRUAL BASIS:**

1. Uncontested FIT is deducted in the year for which it is imposed.

2. Contested FIT is deducted in the year in which the liability becomes fixed and certain, but in no case later than the year in which the tax was actually paid.

3. Refunded FIT is reported in the year received but only if the taxpayer received a prior-year tax benefit from deduction of the FIT refunded.

4. EXAMPLE 7: Using the information in Example 6 and assuming the taxpayer had consistently used the accrual method, the FIT deduction for 19X2 would be $2,200.00
($5,500.00 x 40%).

(4) **CHANGE IN METHOD USED TO COMPUTE/ALLOCATE FIT DEDUCTION**:

(a) Any change in methods must be effective with the first day of a tax year.

(b) Any tax year in which a change of methods occurs is a transition year.

(c) There are two ways the method can be changed:

1. Taxpayer request.

(i) Taxpayer's request must be in writing and must include the reason(s) for requesting the change.

(ii) The taxpayer will receive written approval if the request is granted.

(iii) A copy of the written request for a change in method and the Department's written approval must be submitted with the return.

(iv) Once a change in computation and/or allocation methods is approved, it must be consistently applied from the year of change forward.

2. Change in method required by the Department of Revenue.

(i) Effective with any tax year beginning after December 31, 1998, the Department may select the method (cash or accrual basis) used to compute the federal income tax deduction on resident and non-resident returns. Taxpayers filing a return for a year in which the Department changes the method will be considered to have been granted approval to change methods.

(5) **TRANSITION YEAR RULES**:

(a) Year of change from cash basis to accrual basis: Any FIT refund received must be reported as income and additional FIT paid must be deducted.

(b) Year of change from accrual basis to cash basis: Any FIT refund received during the transition year for previous tax years shall not be reported as income. Any additional tax paid during the transition year for previous tax years may not be deducted.

(c) After a change from cash to accrual method in non-transition years, refunds of previously deducted accrued taxes must be reported as income and payments of taxes for an accrual basis year, not previously deducted, may be deducted.

Author: Richard H. Henninger, Jr., Sharon Norman, Judy A. Robbins, Jack W. Stewart, Sr.
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Adopted September 30, 1982.
Amended: Filed February 8, 1989, effective April 24, 1989.
Amended: Filed September 18, 1996, effective October 23, 1996.
Repealed and New: Filed December 14, 1999, effective January 18,

810-3-15-.21 Deductions for Nonresidents

____(1) A nonresident is an individual who is a legal resident of another state.

(2) The phrase "adjusted gross income from all sources" is comprised of income which would be included in gross income if received by a resident of the State of Alabama in accordance with § 40-18-14, Code of Alabama 1975, less the deductions described in § 40-18-14.2.

____(3) Effective for all taxable years beginning after December 31, 1997:

____(a) Business-related Expenses. The following business-related expenses are deductible in computing Alabama adjusted gross income for a nonresident only to the extent that they are paid or incurred in a trade or business within the State of Alabama:

____1. Ordinary and necessary business expenses in accordance with § 40-18-15(a)(1),

2. Interest expense in accordance with § 40-18-15(a)(2),

3. Taxes in accordance with § 40-18-15(a)(3),

4. Losses in accordance with §§ 40-18-15(a)(4) and (5),

5. Losses from debts ascertained to be worthless in accordance with § 40-18-15(a)(7),

6. Depreciation and amortization in accordance with § 40-18-15(a)(8),

7. Depletion in accordance with § 40-18-15(a)(9),

8. Retirement savings contributions and expenses for qualified pension plans, profit sharing plans, stock bonus plans, and annuity plans in accordance with §§ 40-18-15(a)(11) and (12),

9. Expenses incurred in removing barriers to handicapped persons in accordance with § 40-18-15(a)(19),

10. Section 179 expenses in accordance with § 40-18-15(a)(21),

11. Unreimbursed employee business expenses and expenses described at 26 U.S.C. § 212 in accordance with § 40-18-15(a)(23), and

12. Assistance provided to the State Industrial Development Authority in accordance with § 40-18-15(a)(25).

____(b) Net Operating Losses. The deduction allowed by § 40-18-15.2 for net operating losses shall be deductible only to the extent that a loss arose from a trade or business carried on in Alabama. See § 40-18-15.2.

____(c) Property Located in Alabama - Income Subject to Alabama Tax. The following expenses are deductible in computing Alabama adjusted gross income for a nonresident only to the extent arising from property located in Alabama or transactions producing income that is subject to tax in the State of Alabama:

1. Interest expense in accordance with § 40-18-15(a)(2),

2. Taxes in accordance with § 40-18-15(a)(3),

3. Losses in accordance with § 40-18-15(a)(5),

4. Depreciation and amortization in accordance with § 40-18-15(a)(8),

5. Depletion in accordance with § 40-18-15(a)(9),

6. Ordinary and necessary business expenses in accordance with § 40-18-15(a)(14) and 26 U.S.C § 212, and

7. Expenses incurred in removing barriers to handicapped persons in accordance with § 40-18-15(a)(19).

____(d) Casualty and Theft Losses. The deductible amount of casualty and theft losses allowed by § 40-18-15(a)(6), which references 26 U.S.C. § 165, shall be allowed only for losses arising from property located within the State of Alabama. The limitations in 26 U.S.C. § 165 shall be applied only with regard to the taxpayer's Alabama adjusted gross income.

____(e) Alabama Percentage of Adjusted Total Income. Nonresidents must divide the amount of their Alabama adjusted total income by the amount of their adjusted total income from all sources in order to determine the ratio of Alabama income to income from all sources. This percentage, the Alabama percentage of adjusted total income, is used to determine the deductible amount of certain expenses taken below the adjusted total income line. Alimony paid and adoption expenses are not considered in the computation of the Alabama percentage of adjusted total income - the amounts are not subtracted from either the numerator or the denominator of the fraction. See § 40-18-14.2.

____1. Personal Exemption and Dependent Exemption. A nonresident must prorate the personal exemption by multiplying the amount of the personal exemption by the Alabama percentage of adjusted total income. If Alabama total income exceeds the prorated amount, a Form 40NR must be filed. Dependent

exemptions must be prorated in the same manner using the Alabama percentage of adjusted total income. See § 40-18-19.

2. Federal Income Tax Deduction. The federal income tax deduction must also be prorated using the Alabama percentage of adjusted total income. See Rule 810-3-15-.20.

(i) If the taxpayer is filing separately on the Alabama return, but jointly on the federal return, an intermediate computation is performed before the federal income tax deduction is prorated, and the Alabama percentage of adjusted total income is not used to prorate the federal income tax deduction.

(I) The taxpayer's Alabama adjusted total income is divided by the sum of the spouse's federal adjusted gross income and the taxpayer's adjusted total income from all sources.

(II) The percentage computed in subparagraph (I) is then applied to the amount of the federal income tax liability as shown on the current federal income tax return. The result of the computation is the allowable federal income tax deduction.

3. Optional Standard Deduction. If a nonresident taxpayer elects to claim the optional standard deduction in lieu of claiming itemized deductions, the optional standard deduction must be prorated by multiplying the amount of the optional standard deduction by the Alabama percentage of adjusted total income. See Rule 810-3-15-.19.

4. Other Adjustments and Itemized Deductions. The amount allowed for the following deductions shall be limited to the amount determined by multiplying the total amount of the deduction by the Alabama percentage of adjusted total income.

(i) Interest expense in accordance with § 40-18-15(a)(2),

(ii) Taxes (other than federal income tax)in accordance with § 40-18-15(a)(3),

(iii) Casualty and theft losses in accordance with § 40-18-15(a)(6),

(iv) Charitable contributions in accordance with § 40-18-15(a)(10),

(v) Medical and dental expenses in accordance with § 40-18-15(a)(13),

(vi) Expenses relating to the construction of a radioactive fallout shelter in accordance with § 40-18-15(a)(15),

(vii) The cost of conversion to wood as the primary energy source in accordance with § 40-18-15(a)(16),

____(viii) Alimony in accordance with § 40-18-15(a)(17),

(ix) Expenses relating to the removal of barriers to handicapped persons in accordance with § 40-18-15(a)(19),

(x) Adoption expenses in accordance with § 40-18-15(a)(24), and

____(xi) Qualified long-term care coverage in accordance with § 40-18-15(a)(26).

____(4) Prior to January 1, 1998. Effective for taxable years beginning before January 1, 1998, the provisions of subparagraphs (3)(a) through (3)(e) of this rule were the same except:

____(a) The deductions for alimony, retirement contributions, and early withdrawal of savings penalties were not deductible from Alabama income;

(b) Qualified long-term care coverage was deducted as an adjustment to income - after January 1, 1998, only the percentage applicable to Alabama income is deductible from Alabama income; and

(c) Adoption expenses were not allowable as a deduction for a nonresident - after January 1, 1998, adoption expenses are deductible according to the Alabama percentage of adjusted total income.

Author: Roger Frost, Sharon Norman, Hugh Kirkland, James Lucy, Lee Johnson, and Betty Knowles
Authority: §§40-2A-7(a)(5) and 40-18-15, Code of Alabama 1975
History: Effective September 30, 1982.
Amended June 17, 1988.
Amended September 18, 1996, effective October 23, 1996.
Repealed and New Rule: Filed July 26, 1999, effective August 30, 1999.

810-3-15-.24. Adoption Expenses.

(1) For tax years beginning on or after January 1, 1991, resident individual taxpayers may include as an adjustment to income, reasonable medical and legal expenses paid or incurred by the taxpayer in connection with the adoption of a minor.

(2) "Medical expenses" shall include any medical and hospital expenses of the adoptee and the adoptee's biological mother which are incidental to the adoptee's birth and subsequent medical care which, in the case of the adoptee, are paid or incurred before the petition for adoption is granted.

(3) Expenses associated with the adoption of a minor that are not properly classified as medical or legal expenses as stipulated in paragraphs (1) and (2) above are not to be considered in computing the adjustment to income.

(4) In cases of adoption petitions which are not granted, no deduction for medical and legal expenses will be allowed.

Author:	Anne Simms, Roy Wiggins
Authority:	Section 40-18-15, Code of Alabama 1975
History:	Effective December 4, 1992.
	Amended September 18, 1996, effective October 23, 1996.

810-3-15-.25. Contributions to State Industrial Development Authority.

(1) In computing adjusted gross income under §40-18-15, Code of Alabama 1975, the following shall be allowed as a deduction:

(a) The amount of aid of assistance, whether in the form of property, services or monies, provided to the State Industrial Development Authority pursuant to §41-10-44.8(d), Code of Alabama 1975.

1. The amount of aid or assistance provided shall be deducted in the year contributed.

2. The deduction for property or services shall be the fair and reasonable value of the property or services as determined by the Authority.

3. Any portion of aid or assistance returned pursuant to §41-10-44.8(d), Code of Alabama 1975, shall be included in income in the year in which the refund of the aid or assistance is made.

Author: Tina M. Melancon
Authority: §40-18-15, Code of Alabama 1975
History: Effective date September 30, 1994.
Amended September 18, 1996, effective October 23, 1996.

810-3-15-.26 Qualified Long-Term Care Coverage.

(1) Effective for taxable years beginning after December 31, 1997, the amount of premiums paid for qualified long-term care insurance coverage is deductible as an itemized deduction.

(2) For tax years beginning on or after January 1, 1995, and ending December 31, 1997, individual taxpayers may include as an adjustment to income the amount paid for premiums for qualifying long-term care coverage pursuant to Section 40-18-15.

(3) "Qualified long-term care services" shall include any care for necessary diagnostic, preventive, therapeutic, and rehabilitative services and maintenance or personal care services which are required by a chronically ill individual in a qualified facility or services which are pursuant to a plan of care prescribed by a licensed health care practitioner.

(4) Premiums paid for long-term care insurance contracts are deductible if the contract meets the following requirements:

(a) Offers coverage only for qualified long-term care services and benefits incidental to the coverage.

(b) Guaranteed renewal.

(c) No cash surrender value.

(d) All refunds of premiums and all policyholder dividends or similar amounts under the contract are to be applied as a reduction in future premiums or to increase future benefits, except for a refund of premiums on surrender or cancellation of the policy.

(5) A long-term care insurance contract shall be treated as an accident or health insurance contract. The amount of coverage under the long-term care insurance contract shall be equal to or greater than Medicaid coverage for a period of at least three years.

(6) An insurance contract shall not fail to be treated as a long-term care contract by reason of the payments being made on a per diem or other periodic basis without regard to the expenses incurred during the period to which the payments relate.

(7) A long-term care insurance contract may cover Medicare reimbursable expenses where Medicare is a secondary payor.

(8) In the case of long-term care insurance coverage provided by a rider on a life insurance contract, this regulation shall apply as if the portion of the contract providing long-term care coverage was a separate contract.

(9) The deduction is available only to the person or entity who pays the premiums.

Author: Roger Frost and James Lucy
Authority: §§ 40-2A-7(a)(5), 40-18-15 and 27-47-2, Code of Alabama 1975
History: New rule: Filed May 7, 1996, effective June 11, 1996.
Amended: Filed December 15, 1999, effective January 19, 2000.

810-3-15-.27 Net Operating Loss Carryback or Carryover.

(1) Computation of a Net Operating Loss (NOL).

(a) A net operating loss is the amount by which deductions (after modifications) exceed gross income. A net operating loss may result from losses incurred in a trade or business, from the sale of assets used in a trade or business, or from personal casualties or thefts.

1. For the purpose of computing the amount of an allowable net operating loss, certain items of income, expense or deduction will be classified as "business" or "nonbusiness." The following is a partial list of items regularly classified as business or nonbusiness:

(i) Business. Business income, expense and deductions include, but are not limited to: salary and wages; income or loss from a trade or business; gain or loss from sale of assets used in a trade or business; losses on Internal Revenue Code § 1244 stock (up to the amount of ordinary loss allowed for federal income tax purposes); rental income or loss; income or loss from a partnership; income or loss from an Alabama S corporation; income or loss from farming; employee moving expenses; employee business expenses; and casualty and theft losses.

(ii) Nonbusiness. Nonbusiness income, expense and deductions include, but are not limited to: medical expenses; taxes; interest expense; charitable contributions; miscellaneous deductions other than employee business expenses; gain from the sale of a personal residence to the extent recognized in accordance with § 40-18-14, Code of Alabama 1975; gain or loss from the sale of assets not used in a trade or business (including distributive shares of gains or losses from such assets held by a partnership or an Alabama S corporation); interest and dividend income (including distributive shares of interest and dividend income received by a partnership or an Alabama S corporation); losses on Internal Revenue Code §1244 stock (in excess of the amount of ordinary loss allowed for federal income tax purposes) federal income tax refunds or tax paid; alimony received; taxable pension and annuities; income or loss from a trust or estate; deductible contributions to IRA retirement plans; Keogh retirement plans; employee benefit contributions paid by an employer; penalties for early withdrawal of savings; alimony paid and disability income exclusions.

2. In computing the amount of a net operating loss allowable for a particular taxable year, the following modifications must be made:

(i) no deduction may be taken for any net operating loss carried over from another year,

(ii) no deduction is allowed for the personal exemption or exemption for dependents allowed by § 40-18-19, Code of Alabama 1975,

(iii) nonbusiness deductions, including the federal income tax deduction, may not exceed nonbusiness income, and

(iv) the optional standard deduction, if claimed, is considered a nonbusiness deduction and may not exceed nonbusiness income.

(b) Definitions. As used in this regulation, the following terms have the meanings ascribed to them, unless the context clearly indicates otherwise:

1. "NOL" means "net operating loss."

2. "Carryback" means an NOL applied to a year prior to the year in which the NOL occurred.

3. "Carryover" means the excess NOL after a portion of the NOL has been applied to a carryback or carryforward year.

4. "Carryforward" means an NOL applied to a year subsequent to the year in which the NOL occurred.

5. "Intervening Year" means a year between the earliest year to which an NOL can be carried back and the year in which the NOL occurred.

6. "Loss Year" means the year in which an NOL occurred.

(2) Application of an NOL Carryback.

(a) For loss years beginning after December 31, 1997, an NOL may be carried back and deducted from taxable income in each of the preceding two years or until exhausted.

(b) NOL Carrybacks.

1. When an NOL is carried back to a prior year, taxable income will be recomputed in such prior year as specified in subparagraphs (i), (ii), and (iii) below.

(i) If the NOL being carried back is equal to or greater than taxable income as previously reported or last adjusted (including any deductions for NOLs carried over or carried back to such year from any loss year prior to the current loss year), taxable income will be reduced to zero. See paragraph (5) below for the computation of any remaining NOL for carryover to a subsequent year. See subparagraph 3 for refund procedures.

(ii) If the NOL being carried back is less than taxable income as previously reported or last adjusted (including any deductions for NOLs carried over or carried back to such year from any loss year prior to the current loss year), taxable income for the carryback year is reduced by the amount of the NOL.

(iii) The NOL carryback reduces adjusted gross income, and therefore, will affect those deductions which are based on or limited by a percentage of adjusted gross income.

(I) The limitation on contributions will be reduced.

(II) The amount of medical expenses exceeding 4% of adjusted gross income may increase.

(III) If the optional standard deduction is elected, the amount will be computed by applying the appropriate percentage to adjusted gross income after subtracting the NOL carryback.

2. Recomputation of Tax in a Carryback Year. The appropriate rates for the carryback year will be applied to the amount of taxable income after subtraction of the NOL deduction.

3. Refund Procedures.

(i) To apply an NOL carryback and to request any refund due, complete Form NOL-85A and attach it to Form 40X (Amended Alabama Individual Income Tax Return) for each year to which the carryback is being applied.

(ii) Limitations on Refund Claims. A claim for refund of tax based on an NOL carryback must be filed within three (3) years, including extensions, from the due date of the loss year return.

(I) If the taxpayer has an NOL and fails to claim the NOL carryback within three years, including extensions, from the due date of the loss year return, no refund will be made based on the NOL carryback. The taxpayer will be allowed to carry any available loss forward.

(II) After computing the carryback and reducing the loss available by the taxable income and required modifications for all of the carryback years, a loss may still be available to be carried forward. If so, the remaining available loss may be claimed in the first year following the loss year, providing the loss is claimed when the return is filed for the carryforward year as described in paragraph (4).

4. No deduction will be allowed in any carryback year which has been closed by expiration of the statute of limitations or by final assessment prior to the application of the carryback.

(3) Election to Relinquish the Entire Carryback Period.

(a) A taxpayer may elect to forego the carryback period of an NOL.

(b) If such an election is made, the NOL will then be carried forward to the first available year following the loss year. The carryforward period limitation of fifteen (15) years is not extended if an election is made to forego the carryback period.

(c) For loss years beginning after December 31, 1997, the election to forgo the carryback period can be made in one of two ways. The election can be made on or before the due date (with extensions) for filing the income tax return for the loss year. If no election is made by the due date of the loss year return, then the filing of the next year=s return by the due date, including extensions, and claiming the loss on the return shall be considered the taxpayer's election to forgo the carryback period. The election, once made, is irrevocable.

(d) If a proper election to forego the carryback period is not made, or not timely made, the NOL must be carried back to the earliest year preceding the loss year in which the NOL may be utilized (e.g., a 1998 NOL must be carried back to 1996). Any unused NOL may be carried to the next earliest preceding year, in order.

(4) Application of an NOL Carryforward to a Year After the Loss Year.

(a) Eligible Carryforward Years. An NOL may be carried forward to years subsequent to the loss year in order of time or until exhausted, whichever occurs first; subject to the following limitations:

1. To each of the fifteen tax years following the loss year.

2. No deduction will be allowed in any carryforward year which has been closed by expiration of the statute of limitations or by final assessment prior to the application of the carryforward.

(b) Computation of Taxable Income.

1. If the NOL being carried forward is equal to or greater than taxable income, taxable income will be reduced to zero. Taxable income is computed without considering the current NOL carryover to be applied, but will reflect any prior carryovers which have been applied. See paragraph (5) below for the computation of any remaining NOL for carryover to a subsequent year.

2. If the NOL being carried forward is less than taxable income (computed without considering the NOL deduction to be applied), adjusted gross income will be reduced (but not below zero) by the amount of the NOL carryforward.

(i) The NOL carryforward reduces adjusted gross income, and therefore, will affect those deductions which are based on or limited by a percentage of adjusted gross income.

(I) The limitation on contributions will be reduced.

(II) The amount of medical expenses exceeding 4% of adjusted gross income may increase.

(III) If the optional standard deduction is elected, the amount will be computed by applying the appropriate percentage to adjusted gross income after subtracting the NOL carryforward.

(5) Computation of any Remaining NOL Carryover After Application of an NOL.

(a) In order to determine the amount of an NOL available for carryover, certain adjustments must be made to the taxable income for the year in which the deduction was taken. The amount by which the NOL will be reduced is called "modified taxable income."

(b) The modifications required by law provide that no deduction is allowed for:

1. the personal exemption provided in § 40-18-19(a)(6), and

2. the deduction for dependents provided in § 40-18- 19(a)(7).

(c) These modifications are applied after all prior adjustments or modifications have been made to adjusted gross income and/or taxable income in the year to which the NOL is being applied.

1. If a prior NOL carryback or carryover was fully absorbed in the year, and a subsequent NOL is carried to the year and cannot be fully absorbed, the modifications required in subparagraph (a) above would be computed after taxable income has been recomputed for the year.

2. If the subsequent NOL can be fully absorbed, after taxable income has been recomputed for the prior NOL, taxable income for the year must be recomputed, with adjusted gross income reduced again for the subsequent NOL.

(6) Special Rules.

(a) Joint Returns.

1. In general, in the case of a husband and wife who file a joint income tax return for any taxable year in which an NOL occurs, the loss is to be computed on the basis of the combined income and deductions of both spouses, and the modifications required are to be computed as if the combined income were the income of one individual. However, if separate returns were filed for any of the carryback years, the NOL must be computed as if separate returns were being filed in the joint loss year.

2. Special rules are necessary when there is a change in the status of the spouses due to marriage, divorce or death.

(i) An NOL sustained after or prior to a marriage cannot be used to reduce the taxable income of a former or future spouse, even though a joint return was filed for the carryback and/or carryforward year. The NOL can only be applied to the separate income of the spouse which incurred the loss.

(ii) If there is a change in marital status due to the death of a spouse:

(I) and in a succeeding year the survivor sustains an NOL, the loss may be carried back only to that portion of the income reported on a joint return previously filed with the decedent which is allocated to the survivor.

(II) and a joint return is filed for the year of death of the spouse and an NOL was sustained -

I. the loss may be carried back to a year in which the decedent filed a joint return with the surviving spouse, and/or

II. the loss allocated to the deceased spouse may be carried back to a year in which the decedent filed a separate return.

A. Any NOL allocated to a deceased spouse not utilized in subsentence II, above, may not be carried forward.

(b) Reduction for Allowable NOL, Whether or Not Claimed.

1. An NOL carryback or carryover will be reduced by the amount available for use, whether used or not. For instance, if a taxpayer neglects to claim an NOL carryback within the prescribed time limit, the amount of loss available for carryover to other years will be reduced by the amount that could have been carried back but was not claimed.

2. If the loss was available for use prior to the final assessment, the remaining NOL must be reduced by the amount that was available for use before the final assessment.

(c) NOLs of Nonresidents.

1. In general, nonresidents are allowed the same deduction for NOLs as the deduction allowed to residents, except that the loss must be attributable to sources in Alabama, and is applied to income attributed to Alabama. The computation of the loss, as applied to Alabama source income, is made as provided in paragraph (1) above. The deduction for a carryback is computed as provided in paragraph (2) above. The deduction for a carryover is computed as provided in paragraph (4) above. The computation of any remaining carryover of an NOL that cannot be fully absorbed is computed as provided in paragraph (5) above.

2. A number of deductions allowed nonresidents, including the personal exemption and exemption for dependents, are limited based on the ratio of income from Alabama sources to income from all sources. When an NOL is fully absorbed, these deductions must be recomputed based on the changes to Alabama income and total income after the NOL is applied.

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Authority: Sections 40-2A-7(a)(5) and 40-18-15.2, Code of Alabama 1975.
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